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cc: Mr. Duguid
Mr. Walters

MS

PRIME MINISTER

E, 15 July: Public Sector Pensions

E is considering tomorrow the interim report of the official group which has been looking at the issues raised by the Scott Report on Public Sector Pensions, and the joint memorandum by the Chancellor and the Lord President (E 81 78) covering the report.

The official group has looked at possible changes in both contributions and benefits across the whole spectrum of public sector pensions, and has narrowed down its proposals for future work to the shortlist contained in paragraph 71 (Flag A). Further possible options, not recommended for further work, are contained in paragraph 72.

I am sure, having participated in the work of the group that prepared the report, that the options in paragraph 71 are the right ones, and I hope that E will endorse them. But there are three particular issues on which it would in addition be useful to have Ministerial guidance before further work is undertaken:

i) To what extent do Ministers feel bound by pledges made at the time of the Election? The addendum to the paper (Flag B) summarises these: on the surface they do indicate a continuing commitment to the principle of index linking, and if the Government does not wish to cut back on that commitment then the benefits route is closed, and further work should concentrate on changes in contributions.

ii) Do you agree that, as proposed by the Chancellor and the Lord President in their covering note, the scope of whatever is done about public sector pensions should include as far as possible all public sector groups which enjoyed index linking, and not just those in the public services? We do of course already have considerable difficulties in restraining wage costs in the nationalised industries, and

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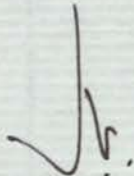
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there should be no doubt that attempting to relate their pension benefits more closely to their contributions would complicate wage negotiations. But it is clear from the work of the group that it is in those areas that the greatest opportunity for financial savings arises, both because of the numbers involved and because of the greater extent to which the cost of pensions are met by contributions in the public services.

iii) There is a particular difficulty of possible overlap between further work by the group on Civil Service pensions, and the Megaw Inquiry. You will recall that Megaw's Terms of Reference do not specify the inclusion of pensions, but the formula - "taking account of other conditions of service and other matters related to pay" - certainly points Megaw in that direction. So I think further work ought to concentrate on non Civil Service public sector pensions (which are about 82% of the total anyway) and on evidence to Megaw about the Civil Service Scheme.



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